

Limited Liability Company



The Elegant Entity



The History Brief

- March 1977 – Wyoming LLC Act (# 1)
- September 1988 – Rev. Rul. 88-76
- January 1990 – Stampede Begins
- June 1996 – Hawaii LLC Act (# 51)
- January 1997 – Check-the-box Regs
- January 1997 – Prop. Reg. 1-1402(a)-2

What Is an LLC?



- A Separate Legal Entity - STATE LAW
- Limited Liability – as a corporation
- Pass Through Taxation – as a partnership



Formation

Articles of Organization

Name [usually some restrictions]

Members [person(s) / entity(ies)]

Management [members / manager]

Registered Agent

Professional Requirements

(Accountants, Attorneys etc)

June 28, 2005



Formation

Operating Agreement Basics

Purpose

Management Duties

Member Duties

Meetings

Contributions and Allocations

Transfer Restrictions

Dissolution and Termination

June 28, 2005



Formation

- **Caveat** – Legal characteristics vary according to state law and competent legal counsel should be sought prior to and during the formation process.
- **Caveat** – Articles of Organization and Operating Agreements determine the tax treatment of payments and distributions. Prior planning is essential.

June 28, 2005



Main Legal Characteristics

- Legal Entity
- Single or Multiple Members
- Rules are a combination of partnerships and corporations
- Limited Liability for the members, not the entity itself
- Business assets are protected from the creditors of the individual members

June 28, 2005



Asset Protection Elements

- **Creditor Piercing Difficult**
- **Assignment or Charging Order**
Not a member so cannot:
 - ✓ Exercise management rights
 - ✓ Force a distribution
 - ✓ Require redemption of interest
 - ✓ Seize specific property of the LLC*{varies by state – check with attorney}*

June 28, 2005



Management Structures

- Member Management (the default)
- Manager Management (limited partnership structure). Managers are not necessarily Members
- Corporate Management format
i.e.: Board of Directors, Officers,
meetings and decision process chosen
by members

June 28, 2005

EIN - TIN

- New Single Member – Not Needed
- New Multiple Member – Form SS-4
- Classification Change – Notice 99-6, 1999-3 IRB 12





Tax Classifications

- Sole Proprietor – Schedule C, F, or E (default for single member LLC)
- Partnership – Form 1065 (default for multiple member LLC)
- C Corporation – Form 1120 (Form 8832 election – C Corp law)
- S Corporation – Form 1120S (Form 2553 election – TD 9139- S Corp Law)

June 28, 2005



Why File Form 8832 or 2553

- Members do not want default
- Members want a change (*5 year waiting period after initial election - Reg. 301.7701....*)
- Doubt as to proper classification
- Late Election Relief (Rev.Proc 2002-59)

June 28, 2005

Self Employment Tax



- General Rule

General Partners pay SE Tax

Limited Partners do not pay SE Tax

Active engagement in the business of an
LLC causes SE Tax treatment



Self Employment Tax

- *Proposed Regulation 1.1402(a)-2(h)(2), (h)(3) and (h)(4) - Definition of limited partner*
- No SE Tax if :
 - No personal liability
 - No authority to contract
 - Works 500 or fewer hours
 - Rental real estate [Reg. 1.1402(a)-4]

June 28, 2005



Multiple Class Exception

- If LLC Operating Agreement provides for at least two classes of interest, and
- Member owns more than one class of interest, then
- Owner may exclude a portion of income from SE Tax IF...

June 28, 2005



Multiple Class Exception

- ...members who are treated as limited partner own a substantial continuing interest (i.e.: 20% or more); and
- The member's rights and obligations are identical with those treated as limited partners

{Operating Agreement must create classes}

June 28, 2005

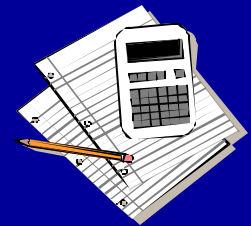


Choose A Comfort Zone

- Very Aggressive – non-managers subject to SE Tax only on guaranteed payments
- Less Aggressive – members active in the business are subject to SE Tax, inactive (passive) investors excluded
- Don't use limited partner rules for LLCs

June 28, 2005

Filing Requirements



- Single Member – Schedule C, F, E
- Multiple Member – 1065
- 1120, 1120S if Form 8832/2553 Election and/or when Single Member is a corporation



State Filing Requirements

- Return for the LLC (some states accept federal in lieu of a state form)
- Individual Returns for resident and non-resident members
- Annual report for the LLC

June 28, 2005



Conversion

- C Corporations can convert to an LLC that is treated as a partnership but...
- Treated as liquidating and distributing assets to shareholders followed by individual shareholder contributions to a newly formed LLC. Could cause double taxation (liquidation rules)



Termination - Liquidation

- **LLC taxed as a corporation**
 - Same rules as corporate liquidation
- **LLC taxed as a partnership**
 - Gain recognized to the extent that money received exceeds members basis. Asset basis reduced by money received

Good Uses of LLC

- Start up companies
- Holding real estate
- Sole Proprietorships
- Venture Capital Projects
- Equipment leasing
- Professionals...





Professional – PLLC /PSLLC

- Usually all members licensed
- Transferable only to licensees
- Liability protection – acts of colleagues
- Special allocations of income, loss and deductions possible
- Allowed in most states
(Prohibited in CA, OR and RI)

The Final Elegance



- Search the complete tax code
- Find the most favorable tax treatment available
- Apply it to your LLC